

UNITED STATES DISTRICT COURT

ORIGINAL

NORTHERN DISTRICT OF CALIFORNIA

Before The Honorable YVONNE GONZALEZ ROGERS, Judge

JAMES FABIAN, individually)	Motion to Dismiss
and on behalf of All Others)	
Similarly Situated,)	
)	
Plaintiff,)	
)	
vs.)	NO. C 19-00054YGR
)	
NANO f/k/a RAIBLOCKS f/k/a)	
HIEUSYS, LLC, et al.,)	Pages 1 - 39
)	
Defendants.)	Oakland, California
_____)	Monday, June 25, 2019

REPORTER'S TRANSCRIPT OF PROCEEDINGS

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(Appearances continued next page)

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Tuesday, June 25, 2019

2:56 p.m.

P R O C E E D I N G S

THE CLERK: Calling civil action 19-0054, Fabian versus Nano.

Counsel, please come forward and state your appearances.

MR. CARRIEL: John Carriel on behalf of plaintiff Fabian.

MR. FRIEDMAN: And Todd Friedman also on behalf of the plaintiff.

THE COURT: Okay. Good afternoon.

MR. FRIEDMAN: Good afternoon.

MR. SCOOLIDGE: Good afternoon, Your Honor. Peter Scoolidge, and with me, my partner Peter Fox for the defendants Hieusys, LLC; Colin Lemahieu, Troy Retzer and, Mica Busch. And with us also is our local counsel Paul Byrne from Cornerstone Law for all these defendants and Zach Shapiro.

THE COURT: Okay. Who's arguing?

MR. CARRIEL: I am, Your Honor.

MR. SCOOLIDGE: My partner Mr. Fox and I are going to split the arguments, Your Honor, if that's okay with the court.

THE COURT: That's fine.

So which arguments are you each taking?

MR. SCOOLIDGE: So Mr. Fox is going to handle the Howey test arguments and the state law arguments, and I'll be

1 handling everything else, Your Honor.

2 **THE COURT:** All right. Let's start with you.

3 **MR. SCOOLIDGE:** So, Your Honor, this is a case about
4 a hack on --

5 **THE COURT:** Hold on. I didn't say you could proceed.

6 **MR. SCOOLIDGE:** Apologies.

7 **THE COURT:** All right. Number of things to take care
8 of. First with respect to the Section 15(a) and Section 12
9 claims, it seems to me that Section 15(a) rises and falls with
10 the analysis of Section 12(a)(1).

11 Would you all agree with that?

12 **MR. CARRIEL:** Yes, Your Honor.

13 **MR. SCOOLIDGE:** Yes, Your Honor.

14 **THE COURT:** Okay.

15 So we'll start with you, Mr. Carriel, on that Section
16 12(a)(1) claim because the statute seems to be pretty explicit
17 that you have to bring those actions within one year after the
18 violation upon which it was based.

19 And while the Ninth Circuit hasn't ruled specifically on
20 whether equitable tolling is appropriate in this situation,
21 every circuit that has rendered an opinion on that topic has
22 said that it doesn't exist. Right?

23 So the First, Second, Third, Fifth, Sixth and Eighth
24 Circuits say there is no equitable tolling. So why would I,
25 as a district court, say something different from 18 other

1 judges on the circuits about that topic?

2 We'll start there.

3 **MR. CARRIEL:** Well, I think the Ninth Circuit is
4 pretty progressive, and there's nothing --

5 **THE COURT:** So's the Second Circuit.

6 **MR. CARRIEL:** But there's nothing against going --
7 nothing wrong with going against the trend, I would say. But
8 the facts in this case --

9 **THE COURT:** What law do you rely on which would
10 suggest that the Ninth Circuit would do something different
11 than six other circuits?

12 **MR. CARRIEL:** I wouldn't rely on any law in
13 particular to suggest that.

14 **THE COURT:** Well, I have to -- I can't pull it out of
15 thin air. I can't pull it out of thin air, so what would I --
16 if I oppose six other circuits, what am I supposed to base it
17 on? It's supposed to be a reasoned analysis.

18 **MR. CARRIEL:** Hmm. I believe that there is an
19 argument to be made that *American Pipe* can come into play and
20 that *China Agritech* is narrowed to cases in which class
21 certification was denied.

22 And the facts in this case are quite different in that the
23 first class action that was filed was settled on an individual
24 basis, and there are a slew of other factual items to lend
25 toward the idea that it would be equitable to toll this claim

1 in the fairest sense.

2 **THE COURT:** So in the -- wasn't it in the *China*
3 *Agritech* case, the Supreme Court, where it said or observed
4 that allowing successive class actions based upon the *American*
5 *Pipe* rule would allow the statute of limitations to be
6 extended time and again. As each class is denied
7 certification, a new named plaintiff could file a class
8 complaint that resuscitates the litigation.

9 **MR. CARRIEL:** Yes, Your Honor.

10 **THE COURT:** So doesn't that totally undercut your
11 argument?

12 **MR. CARRIEL:** I don't believe so. So the key
13 language in that passage is that each time a class is denied
14 class certification, that did not occur here. There was no
15 motion for class certification ever filed.

16 **THE COURT:** Wasn't it your law firms --

17 **MR. CARRIEL:** No.

18 **THE COURT:** -- that --

19 **MR. CARRIEL:** I'm with Levi & Korsinsky. It was my
20 co-counsel's law firm, Silver Miller.

21 **THE COURT:** Yeah, so Silver & Miller represented the
22 plaintiff in the *Brola vs. Nano* case.

23 **MR. CARRIEL:** Yes, Your Honor. But the decision to
24 settle is the plaintiff's decision. It's -- I wasn't there.
25 I can't speak to what happened, but it is the plaintiff's

1 decision. It's --

2 **THE COURT:** Yeah, but you're arguing prejudice based
3 upon your own actions; that is, the lawyer's actions.

4 **MR. CARRIEL:** I believe that it --

5 **THE COURT:** It's like -- it's like internally my
6 next-door neighbor has defrauded my client. Well, it's the
7 same law firm.

8 **MR. CARRIEL:** Again, I can't speak to how those
9 events went down. But my understanding of how any settlement
10 would come out is that it is the client's decision at the end
11 of the day. The law firm cannot force the client to keep the
12 class action open.

13 So if the defendant made a really great offer, and the
14 plaintiffs took the offer, that's -- it shouldn't prejudice
15 this class.

16 **THE COURT:** Well, except that the plaintiff could
17 have substituted in a new plaintiff. Right?

18 **MR. CARRIEL:** Yeah.

19 **THE COURT:** Knowing that the *American Pipe* rule
20 wouldn't allow any subsequent -- I mean, based upon six
21 circuits -- six different circuits' analysis wouldn't have
22 allowed a separate cause of action to proceed.

23 **MR. CARRIEL:** Right. Another client could have
24 stepped in. But, again, I was not involved in that process
25 whatsoever. My firm doesn't become involved until January of

1 2019.

2 **THE COURT:** I had your firm -- Mr. Silver appeared in
3 that case July 18th, 2018.

4 **MR. CARRIEL:** I'm from Levi & Korsinsky.

5 **THE COURT:** You're both representing this class or
6 this --

7 **MR. CARRIEL:** Correct.

8 **THE COURT:** -- purported class, so it's -- so when I
9 talk about "you" as lawyers, it's both of you.

10 **MR. CARRIEL:** Right. But we can't discuss the
11 specifics of the settlement of what happened internally,
12 because it was a confidential settlement, I have no idea what
13 the settlement was.

14 **THE COURT:** I'm just telling you that one of the
15 lawyers for this class was the lawyer for the class that you
16 said harmed them and appeared in that case prior to the
17 settlement by almost four or five months. It's not something
18 that I can ignore.

19 **MR. CARRIEL:** I'd agree with you, Your Honor. But
20 I -- I would say that if you decided to not toll the class
21 claims, the individual claims should survive for Section
22 12(a)(1) under *American Pipe* and *China Agritech*.

23 **THE COURT:** And on what ground?

24 **MR. CARRIEL:** That's what happened after *China*
25 *Agritech* was sent back down.

1 **THE COURT:** Okay. A response?

2 **MR. SCOOLIDGE:** So, Your Honor, I think that the
3 significance of whether class cert was granted or denied is
4 not discussed in any of those cases. Really, it's about
5 whether the plaintiff would have been on notice of the class
6 action and whether the plaintiff's rights were thought to be
7 protected by the class action. The significance of class cert
8 being denied or not really is just the way that the case
9 ended, and the plaintiff then realized that they had to go
10 file their own case.

11 And I think that here, I mean, plaintiff's counsel hasn't
12 offered any kind of rationale for why class cert being granted
13 or denied has any significance in the analysis.

14 **THE COURT:** He suggests that after *China Agritech*,
15 that the individual claims were not dismissed.

16 Is that true?

17 **MR. SCOOLIDGE:** That's correct, Your Honor. Under
18 *China Agritech*, somebody with an individual claim could still
19 bring it. They just can't be a successive class plaintiff,
20 class --

21 **THE COURT:** So what's your --

22 **MR. SCOOLIDGE:** -- representative.

23 **THE COURT:** So you would agree with him that I could
24 apply it -- apply the rule as to the class but not as to the
25 individual.

1 **MR. SCOOLIDGE:** Well, the problem is that there's
2 always statutes of repose, Your Honor. But I agree with that
3 statement that Your Honor made.

4 The statute of repose is a three-year statute of repose.
5 And actually in paragraph 1, sentence 1 of the complaint, the
6 plaintiff admits that the coin was available for trading in
7 October 24, 2015.

8 **THE COURT:** Well, he says in paragraph 129 that he
9 purchased it on August 16th, 2017.

10 Isn't that when the statute begins?

11 **MR. SCOOLIDGE:** The statute begins when it's first
12 bona fide offered to the public, so that would be the first
13 time that the public is able to get it.

14 **THE COURT:** But he has no standing until he
15 purchases. And if it is a rescissionary claim, then doesn't
16 the statute begin to run when he purchased it as a matter of
17 law?

18 **MR. SCOOLIDGE:** Well, the statute of repose I think
19 just forecloses claims, period, against the set of defendants
20 who bona fide public-offered a security. So assuming it's a
21 security, and we dispute that, the fact that the defendants
22 released it for distribution to the public in 2015 would be
23 what would trigger the statute of repose.

24 And, again, paragraph 1 of the complaint, they state that
25 it was available for trading -- XRB was available on BitGrail

1 October 20, 2015.

2 **THE COURT:** Okay. A response?

3 **MR. CARRIEL:** Your Honor, it does come down to when
4 XRB was -- was a -- bona fide available for -- bona fide --

5 **MR. SCOOLIDGE:** Bona fide offered to the public.

6 **MR. CARRIEL:** Bona fide offer for the public, so the
7 definition of "bona fide offer to the public" is when -- when
8 was XRB available to purchase or sell. And XRB was not
9 available to purchase or sell until 2017, not 2015.

10 2015 potentially is whether the Nano faucet began, but
11 that's an entirely separate issue. The issue here is when was
12 it bona fide offered to the public. And that's when it was
13 available to buy it or sell it, and that did not occur until
14 2017.

15 And so the statute of repose does not start ticking until
16 2017, and it would not run out until 2020, so this should be a
17 non-issue in our view.

18 **MR. SCOOLIDGE:** So, Your Honor, for one thing,
19 there's not a purchase or sale test for when it's bona fide
20 offered to the public. It's just when it's offered to the
21 public.

22 And for another thing -- I'm just going to read the
23 sentence I'm referring to. It says that, this is a class
24 action on behalf of a class of investors consisting of all
25 individuals and entities --

1 **THE COURT:** Well, he doesn't -- he doesn't dispute
2 that you might have been there, right, in --

3 Well, the reference in the complaint to October 24th,
4 2015, why do you have that date?

5 **MR. CARRIEL:** I think that's a -- a carryover from
6 when we initially believed that XRB became publicly available.
7 But as we learned more about the case and, as is alleged
8 throughout the complaint, that that date is too early.

9 So the faucet did not begin until 2016, and it was not
10 publicly available to buy or sell or trade on exchanges until
11 2017. And that is a consistent theme throughout the
12 complaint.

13 **THE COURT:** So you --

14 (Simultaneous colloquy.)

15 **MR. CARRIEL:** -- narrow the class definition.

16 **THE COURT:** Okay.

17 **MR. CARRIEL:** But I was taught to always use the
18 biggest class definition you can and then --

19 **THE COURT:** Well, until it gets in you trouble.

20 **MR. CARRIEL:** I hope so.

21 **THE COURT:** Okay. If the case doesn't survive
22 because there is -- well, at least as to the class, it's time
23 barred, then I don't ever get to the *Howey* test, right?

24 **MR. SCOOLIDGE:** Well, Your Honor, we would argue that
25 the court should actually reach that because this is the

1 second case like this now, and we think that if the court
2 doesn't rule on the securities issues that there may very well
3 be another case like this after this one's dismissed by the
4 same plaintiffs, so we would request that the court actually
5 rule on it.

6 **THE COURT:** Why would I reach an issue I don't have
7 to reach?

8 **MR. SCOOLIDGE:** To deter further lawsuits of this
9 nature, Your Honor.

10 **THE COURT:** Well, it's not clear to me, so we can go
11 through it, but --

12 Okay. That test is four parts. Investment of money, part
13 one? They had to --

14 **MR. FOX:** Your Honor --

15 **THE COURT:** They had to invest money -- I mean, after
16 the faucet, right?

17 **MR. FOX:** Well --

18 **THE COURT:** The faucet was free.

19 **MR. FOX:** Well, faucet was free, and -- and that was
20 it with respect, Your Honor.

21 **THE COURT:** Well, 129 says differently.

22 **THE CLERK:** Can you move the mic to you and not stand
23 in between.

24 **MR. FOX:** Sure. Certainly.

25 There's no allegations in the complaint that the

1 defendants raised any capital whatsoever. The capital that
2 went into this project was their sweat equity and their money.

3 129 may have a conclusory assertion, but there's no -- oh,
4 okay.

5 Yeah, well, so 129 looks to be an allegation that Fabian
6 bought some bitcoin, which I think is unrelated transaction.

7 If you go down to paragraphs --

8 **THE COURT:** Right. And then he used the bitcoin --

9 **MR. FOX:** -- 134 and 135, you've got allegations that
10 he purchased the Nano coin on an exchange from persons
11 unknown. There's no allegation that his purchase was
12 connected to the release of the Nano coin.

13 And in fact, if you look at I believe it's paragraph 75
14 through 78, you'll see a description of how all the Nano coins
15 that exist in the world came to be released, and that was
16 through the free faucet.

17 The fact that after their release, because they proved
18 useful, because of the network effects that grew with -- with
19 their distribution, they took on value, is -- is frankly
20 irrelevant for the purposes of *Howey*.

21 The security law -- securities laws are concerned about --
22 with what happens when someone makes an investment, gives
23 something up to an enterprise in exchange for a promise to
24 share in the profits that the enterprise generates with that
25 investment. That's -- that's missing here.

1 **THE COURT:** Response.

2 **MR. CARRIEL:** Well, not all of the Nano coins were
3 distributed. It says right here in paragraph 79 that the
4 defendants kept 7 million XRB for themselves to fund the
5 further development of the Nano ecosystem. The faucet is
6 irrelevant.

7 This really comes down to when were the XRB offered for
8 purchase or sale. This has nothing to do with the faucet.
9 That was just background to explained -- explain what this
10 case is about.

11 **MR. FOX:** It --

12 **MR. CARRIEL:** Or the factual basis underlying it.

13 **MR. FOX:** With respect to -- to opposing counsel, it
14 can't be background when you're talking about *Howey*, when
15 you're talking about a security. The capital raised is --

16 **THE COURT:** Well, what do you mean, it can't be --
17 what he just said was -- I get background in complaints all
18 the time. I totally do not understand that statement. Makes
19 no sense to me.

20 **MR. FOX:** Well, it -- it could be background, but in
21 that case, there's nothing in the complaint to explain how any
22 capital was raised or how these -- these coins were
23 distributed to the public. The allegations in paragraphs 134
24 and 135 about -- about the -- Mr. Fabian's purchases on
25 BitGrail do not contain anything to indicate that the

1 counter-party was Nano or that the transactions involved any
2 sort of capital raising. This was a secondary market. This
3 was an exchange.

4 **THE COURT:** Okay. So --

5 **MR. CARRIEL:** Your Honor, if I may?

6 **THE COURT:** -- can you get beyond the argument -- if
7 I gave you leave to amend, could you allege a direct
8 transaction with the defendants?

9 **MR. CARRIEL:** Yes, Your Honor. The complaint
10 actually does include several paragraphs --

11 **THE COURT:** Which?

12 **MR. CARRIEL:** -- detailing --

13 Well, I wouldn't be able to pinpoint that to you at this
14 moment, but --

15 **THE COURT:** Look at it. That's why we're here?

16 **MR. CARRIEL:** I'm sorry?

17 **THE COURT:** Look at your complaint --

18 **MR. CARRIEL:** Right.

19 **THE COURT:** -- and tell me what you're relying on.

20 (Pause in the proceedings.)

21 **THE COURT:** I mean, this is a pretty fundamental
22 question. The direct transaction between the defendants and
23 the plaintiff.

24 (Pause in the proceedings.)

25 **THE COURT:** So if you can't find it, tell me what you

1 would allege it to say. I mean, sure you understand how the
2 transaction worked, right?

3 **MR. CARRIEL:** Yes, Your Honor.

4 So what I'm referring to are specific sales of XRB that
5 the Nano defendants made where --

6 **THE COURT:** But what I'm concerned about is what did
7 Mr. Fabian, who is the only plaintiff here -- what was his
8 transaction with the named defendants.

9 Is there a direct transaction, or did Mr. Fabian only
10 receive his Nano through the secondary market?

11 **MR. CARRIEL:** Mr. Fabian received his Nano through
12 the secondary market; however, that secondary market was
13 created by the Nano defendants -- commissioned by them, and
14 for all intents and purposes, run by them.

15 **THE COURT:** Okay.

16 And do you have any law for the proposition that that's
17 sufficient to satisfy the *Howey* test?

18 **MR. CARRIEL:** Which element of the *Howey* test? The
19 common enterprise or --

20 **THE COURT:** Well, I think --

21 (Simultaneous colloquy.)

22 **THE COURT:** -- probably be -- in fact, I think it
23 probably cuts across all of them.

24 Do you have anything for me to look at?

25 I get securities cases all the time, right? And these are

1 investors who are suing under the securities laws because they
2 purchased something directly from the defendant and something
3 happens and there're misrepresentations and the -- and the
4 stock price, you know, drops and so they sue.

5 **MR. CARRIEL:** So our claims aren't about -- or our
6 securities claims aren't about misrepresentations. They're
7 about the offer or sale of Nano, the security. So if the --
8 if Nano is a security, then they're strictly liable.

9 So the question is, what is the investment or money? He
10 invested bitcoin into a common enterprise. The common
11 enterprise is the Nano development team and the Nano
12 development fund, the 7 million XRB that was sold to continue
13 funding the development of Nano.

14 Expectation or profit is that they were relying on the
15 abilities of the Nano team to develop XRP -- XRB and increase
16 its value by doing so.

17 **THE COURT:** Do you want to respond?

18 **MR. FOX:** I'm not sure that I have much new to add,
19 Your Honor. *Howey* requires an investment with the promoters,
20 with the enterprise. Buying something on a secondary market
21 that is not already a security doesn't make it a security.

22 It's not that Mr. Fabian would have needed to buy the
23 security directly -- buy the coin -- excuse me -- buy the coin
24 directly from our clients to make it a security. It's that
25 someone would have needed to. And that never happened.

1 There was only one release of the coin, and it's pled very
2 clearly in the complaint in paragraphs 70, 71, 72 and then
3 specifically 75 and 78, it was all released for free.

4 Your Honor, this -- this is a situation that in some ways
5 is analogous to, you know, if 130 years ago, our clients had
6 invented the telephone, it's useless unless other people are
7 using it. And so they gave it away for free to create value
8 for the product that -- that they had developed.

9 It doesn't have to do with raising capital. There was
10 capital that was used to develop the Nano coin. It was -- it
11 was the hard work and the sweat of our clients. And to the
12 extent that it required money, it was their own money.

13 Nobody, not Mr. Fabian or anyone else, was asked to give
14 anything up in connection with the release of these coins.

15 And, you know, if you look at the other ICO cases that
16 have been coming down, some of which have been cited in the
17 briefing, the distinction is very clear. All of those cases
18 involve capital raising. They're all -- they all involve an
19 exchange of a coin for a token or some sort of instrument
20 for -- for value, for money, usually fiat currency or
21 cryptocurrency. That's -- that's simply missing here.

22 **THE COURT:** Okay. Any response?

23 **MR. CARRIEL:** Your Honor, the Nano team did not
24 develop the telephone. They're developing -- they're still
25 developing XRB. It's a continuous project. It wasn't

1 something that was created and then given away for free. It's
2 continued to be -- it -- it's still being worked on. And they
3 are funding their efforts through the sale of XRB, which only
4 has value through their work.

5 **THE COURT:** Okay. Let's move on unless you want --
6 anybody want to say anything more about the *Howey* test?

7 **MR. CARRIEL:** Your Honor, I would ask that we would
8 be granted leave to amend to allege additional more specific
9 facts for that if you're inclined to deny it.

10 **THE COURT:** You mean "grant"?

11 **MR. CARRIEL:** Or grant it, yeah.

12 **THE COURT:** And any comments on whether or not the
13 defendants are statutory sellers?

14 **MR. CARRIEL:** So the test under *Pinter v. Dahl* is
15 there are two types of sellers. There's either the direct
16 seller. That is the individual or entity that transfers title
17 to the security at issue. Or the statutory seller, which is a
18 person or entity who successfully slits -- solicits the
19 purchase of a security for their own financial benefit or
20 another person's financial benefit.

21 The Nano defendants developed XRB, commissioned the
22 creation of BitGrail, the exchange where XRB could be sold,
23 and then ushered and urged investors or the general public to
24 purchase XRB on BitGrail.

25 They solicited, and successfully so in the case of my

1 client Fabian and the putative class, those individuals to
2 purchase XRB on Bitgrail for either their own personal
3 financial benefit or for the financial benefit of other users
4 on BitGrail or BitGrail itself, through commissions and any
5 sort of arrangements that they might have with Nano.

6 **THE COURT:** So I have the test as coming out of
7 *Pinter*.

8 Is that wrong?

9 **MR. SCOOLIDGE:** That's correct, Your Honor. *Pinter*
10 *vs. Dahl* as interpreted by subsequent cases.

11 **THE COURT:** Okay. So under that test, the statutory
12 seller's standard by way of solicitation is one where
13 liability would extend to a person who, one, successfully
14 solicits a purchase; and, two, motivated in part at least by a
15 desire to serve their own financial interests or those of the
16 securities owner.

17 Now, I know you take issue with the fact that this is a
18 security, but let's assume for purposes of argument that I
19 find it is. Sounds like you would meet the test.

20 **MR. SCOOLIDGE:** Well, Your Honor, we -- we don't
21 think that there would be statutory seller liability here.

22 So the test is that the defendant has to have successfully
23 solicited the sale of the security. And here, at most -- and
24 this came out really in the opposition briefing -- the only
25 statements they rely on are that there's four Twitter posts,

1 and three of them were made after Mr. Fabian bought his coins,
2 after December 12, 2017. Only one of them actually predates
3 it. And that statements reads something like "XRB now
4 available on BitGrail."

5 There's no allegation in the complaint that Mr. Fabian
6 read that specific statement. And there's no allegation that
7 it successfully induced him to buy the coin.

8 And it's important to keep in mind that what *Pinter vs.*
9 *Dahl* did was it substituted something for actual passing of
10 title. And so merely making a statement followed by a
11 purchase isn't enough. There has to be something more
12 substantial than that. And that something more substantial is
13 that it was successful in inducing the purchase.

14 And the case law following *Pinter* all involves defendants
15 who were directly in contact with the plaintiff inducing the
16 purchase in a substantia way, not just a director showing up
17 at a road show, not just making statements that the plaintiff
18 may or may not have heard. The defendants must have
19 successfully solicited the sale, so we think that the
20 complaint fails here, Your Honor.

21 **THE COURT:** All right. A response?

22 **MR. CARRIEL:** Your Honor, the Nano team created XRB.

23 **THE COURT:** Is there any -- is there any pre-purchase
24 solicitation that you can point to that your client relied on?

25 **MR. CARRIEL:** The complaint explicitly states that

1 our client followed and viewed all of the -- the Nano team's
2 social media posts, including --

3 (Simultaneous colloquy.)

4 **THE COURT:** -- agree with the defense counsel that
5 everything except for the one part that says it's available
6 happened after the purchase. Do you have anything else?

7 You can't -- by definition, you can't rely on something
8 for your purchase if it happened after you purchased it.

9 **MR. CARRIEL:** Correct, Your Honor. However, the Nano
10 team created XRB, so anything that our client learned about
11 XRB, he had to have learned it from Nano. Seems obvious.

12 **THE COURT:** Why is that obvious? People write about
13 things all the time. Could have picked up *Wired* magazine. He
14 could have -- well, I guess no one picks up a magazine
15 anymore, right?

16 He could have read some blog or some post or something by
17 someone else. That's not at all obvious to me.

18 **MR. CARRIEL:** In that case, Your Honor, the complaint
19 might not have those specific allegations in its current
20 state, but there are numerous that we could include.

21 **THE COURT:** All right.

22 **MR. SCOLLIDGE:** Your Honor, I think that they had a
23 pretty good chance to include this stuff. This is the second
24 case they filed.

25 **THE COURT:** It may be, but this is the first in front

1 of me. And I can guarantee you that if I find in your favor
2 without leave to amend and it goes to the Ninth Circuit, the
3 Ninth Circuit is going to throw it right back at me about a
4 year and a half from now and I have to redo it.

5 **MR. SCOOLIDGE:** Fair enough, Your Honor.

6 **THE COURT:** The issue of ex-territorial application.
7 So any comments, or you going to rest on your papers?

8 **MR. SCOOLIDGE:** Your Honor, for the defendants, think
9 we'll just rest on the papers.

10 **MR. CARRIEL:** For the plaintiffs as well. I think
11 it's pretty clear-cut, so --

12 **THE COURT:** All right. State law claims.

13 First, with respect to the breach of implied contract, I
14 would say I don't see that the complaint alleges any kind of
15 express or implied contract. You have to identify what the
16 specific terms are of the contract, and you haven't done that.
17 Just -- what are they?

18 What does the contract say, implied or not?

19 **MR. CARRIEL:** The contract in this case is that
20 depositors or users of the BitGrail exchange will deposit
21 their funds and purchase XRB, and their funds will not go
22 missing. It is complied that an exchange will not lose their
23 funds.

24 The Nano team is a party to these contracts because they
25 commissioned the creation of BitGrail. They controlled

1 BitGrail's actions with respect to XRB and XRB code that
2 allows for the transfer of one XRB to -- from one investor to
3 another investor.

4 And when there was an issue with that code -- I'm sorry.

5 **THE COURT:** Let me ask you this.

6 **MR. CARRIEL:** Hm-hmm.

7 **THE COURT:** Just occurred to me as I was sitting
8 here. In the Wild West, you deposited funds in a bank, and
9 someone came and robbed the bank. Your funds went missing.

10 Is there an implied contract that they wouldn't go missing
11 when it was pretty common that banks got robbed all the time?

12 **MR. CARRIEL:** Your Honor, the funds were not stolen
13 in that sense in this case.

14 **THE COURT:** They weren't? What happened to them.

15 **MR. CARRIEL:** The funds went missing because there
16 was issue with the code that allows for the transfer of one
17 XRB -- of XRB from one person to another that resulted in a
18 double-spending or a double-depositing of that asset. So
19 every time you'd deposited two XRB you would get four XRB out
20 of thin air, which really just meant that their money --
21 there'd be money going missing.

22 And that issue was caused due to a flaw in the coding
23 which was run by the Nano team.

24 **THE COURT:** And -- and they didn't reengineer that
25 after the fact?

1 **MR. CARRIEL:** No, Your Honor.

2 And the exchange owner issued a statement detailing how he
3 begged the Nano team to let him take off the -- take the
4 exchange off line because of this flaw. And the Nano team
5 forced him to keep it open, which --

6 **THE COURT:** Where is that in the complaint?

7 (Pause in the proceedings.)

8 **THE COURT:** Is it there?

9 **MR. FOX:** Yeah, it's at paragraph 100.

10 **THE COURT:** All right. Thank you.

11 Okay. What else do you have on implied contract?

12 **MR. CARRIEL:** I'm sorry, Your Honor?

13 **THE COURT:** What else do you have with respect to
14 that topic of an implied contract?

15 **MR. CARRIEL:** That's really about it, Your Honor.

16 **THE COURT:** Okay. Any response?

17 **MR. FOX:** Yes, Your Honor. If I may.

18 Even if the complaint adequately pled a contract between
19 Mr. Fabian and BitGrail, which it clearly doesn't and you can
20 refer to our papers for more on that, I'm not aware of any law
21 that would impose contractual obligations on a non-party to
22 the contract, at least in the absence of some sort of piercing
23 of the corporate veil or allegations of an assignment.

24 There may be some other exceptions that I'm thinking of,
25 but they're not -- they don't appear in the -- in the

1 complaint.

2 **THE COURT:** Okay.

3 I had you, while you were sitting there waiting through
4 the other case, read the *Cleveland vs. Johnson* opinion.
5 Neither of you cited that to me. This is 209 Cal App. 4th
6 1315, California Court of Appeal decision, which relates to
7 the next set of topics on the claim for breach of fiduciary
8 duty and, by extension, the one for aiding and abetting, and
9 the one for constructive fraud.

10 That case seems to lay out a relatively broad standard by
11 which confidential relationships or fiduciary relationships
12 exist under California law. And in particular, in the case
13 where you've got promoters as being fiduciaries.

14 So comments on the application of that case to this
15 matter.

16 **MR. FOX:** Sure, Your Honor.

17 This is a case where there was a promoter. This is a case
18 where there was -- I don't know -- I -- a bit of a slow
19 reader. I didn't read all of the procedural posture. I'm not
20 sure why there wasn't a 10(b)(5) case here, but it would
21 appear that there was a security. There was an investment.

22 **THE COURT:** Well, it's a California case. It's not
23 a -- it's not a federal case.

24 **MR. FOX:** Yeah, no, I -- I understand. And I don't
25 know why the plaintiffs pled it the way that they did.

1 But my point is you had a contribution of capital here and
2 a promise to participate in an enterprise and share in its
3 returns. That's not present here.

4 You know, indicative of that, in that case -- wouldn't
5 always have to be true, but where you're talking about a
6 closed corporation, often is -- you've got parties that know
7 each other, parties that are speaking to each other, parties
8 that are communicating with each other. They're making
9 promises. They're taking investments.

10 Our clients don't know Mr. Fabian from Adam. And there's
11 no allegations in the complaint to the contrary. Indeed,
12 there's no allegations not only that -- did they -- that -- no
13 allegations that they had any communications, there's no
14 allegations that any statements made by any of our defendants
15 were even read or relied upon by Mr. Fabian.

16 So in our view, the -- the case is easily distinguishable
17 on the facts. There's just no investment here. There's no
18 business relationship. There are no promises going back and
19 forth.

20 **THE COURT:** Okay. Response?

21 **MR. CARRIEL:** Your Honor, I disagree.

22 There are multiple statements that the Nano team made
23 assuring investors that their funds were safe on BitGrail,
24 promising them that -- promising investors and our client that
25 they could trust defendant Firano, the CEO of BitGrail, making

1 statements such as, I speak to -- or I speak to Firano every
2 day. He's a great guy. You can trust him. The funds are
3 safe.

4 (Simultaneous colloquy.)

5 **THE COURT:** But, you know, again, all of these -- and
6 in this regard, it bleeds over to the fraud claim, the
7 misrepresentation claims -- again, everything in the complaint
8 except for one post, which is pretty innocuous -- happened
9 after your client acquired -- I'm not even going to say
10 purchased, but your client acquired the Nano.

11 **MR. CARRIEL:** Yes, Your Honor.

12 **THE COURT:** Right?

13 **MR. CARRIEL:** So the first claim --

14 **THE COURT:** And so -- hold on.

15 Under the law, under California law, you must plead
16 reliance. That goes to fraud, negligent misrepresentation.
17 By definition, you have nothing in this complaint that shows
18 any reliance, much less justifiable reliance, because you've
19 pled nothing prior to October --

20 **MR. CARRIEL:** December 12th, 2017?

21 **THE COURT:** Yes.

22 **MR. CARRIEL:** So the first claim about the purchase
23 of the unregistered security, that's all about the
24 acquisition. The rest of the claims are about what happened
25 after the acquisition, which is the Nano team became aware

1 that there was issue with the code, that this double-spend
2 problem was occurring, and they hid it from investors,
3 assuring them that they could leave their funds on the -- on
4 the exchange. So the reliance is in trusting that their funds
5 were safe, not buying XRB, if there was a reliance
6 requirement.

7 The breach here is that they concealed the fact that --

8 **THE COURT:** Well, there is a reliance requirement for
9 a number of these state law claims.

10 I mean, have you --

11 **MR. CARRIEL:** The -- the reliance is in -- when
12 public information was coming out, that there was a problem
13 with the code, that money was going missing on the BitGrail
14 exchange.

15 The Nano team came out in support of BitGrail and told
16 them that they're handling it, we're working together,
17 everything's fine, your money's safe, when, in fact, they knew
18 that it was not safe, as alleged in paragraph 100 with the
19 CEO's statements from Bitgrail, who said he was forced to keep
20 the exchange, even though he warned the Nano team that there
21 was a problem with the funds.

22 So our client and the putative class, when they heard
23 about these issues and they heard that their money was going
24 missing, they relied on the assurances from the Nano team in
25 leaving their funds there instead of withdrawing.

1 **THE COURT:** But you don't allege anywhere that the
2 damage is the fact that you left the funds there and did not
3 withdraw them before the problem or related to the problem.
4 You don't allege that anywhere.

5 I haven't analyzed whether or not that's a viable claim in
6 any event, but that's not alleged. So I hear you saying you'd
7 like to allege that.

8 Does that suffice? Defense?

9 **MR. FOX:** Yeah, it suffices insofar as there's no
10 allegations of that. And we -- we haven't analyzed whether
11 that would be a viable claim or not, but it -- it -- in the
12 big picture --

13 **THE COURT:** So you haven't analyzed that.

14 **MR. FOX:** Well, it -- it is difficult to understand
15 how any sort of duties could arise, be they fiduciary, be they
16 contractual, be they intentional as with respect to fraud --
17 how any duties could arise after the transaction. That's --
18 that's my off-the-cuff analysis.

19 You have -- you have two transactions that are pled here.
20 They occur in September 2017 and December 12th, 2017. All the
21 statements except for one occurred after that. And you have
22 two parties that are remote from each other, that have no
23 business dealings with each other, that don't know each other.

24 I don't see how any of these duties could arise.

25 As for -- I mean -- and getting to the specifics, as for

1 fraud, thinking about could you plead reliance on, you know,
2 that you relied in your decision to hold, how would they --
3 how would they ever allege scienter?

4 How could the y -- you know, these types of claims --

5 **THE COURT:** Well --

6 (Simultaneous colloquy.)

7 **MR. FOX:** -- need to be pled with particularity, Your
8 Honor.

9 **THE COURT:** Right. But stop for a moment.

10 Scienter isn't your -- well, scienter is a complicated
11 problem because rarely do plaintiffs have all the information
12 that they need even when there is scienter. So they do what
13 they can, and, you know, I take a look at what it is that
14 they're prepared to allege. But scienter is always a
15 challenging topic.

16 This isn't a 12(b)(5) case. It's a common law fraud case
17 in terms of what the -- that particular claim is all about.

18 **MR. FOX:** Fair --

19 **THE COURT:** But certainly if -- if they've got
20 allegations -- and, again, I haven't analyzed it. I'm not
21 exactly sure how you -- how this would all flow given that all
22 of these statements were made after the fact -- if you have
23 someone who is there and they've alleged that he is telling
24 the internal person not to -- not to fix the code which is
25 causing the damage, one could plausibly in- -- infer that they

1 are trying to defraud and trying to protect themselves by
2 that, so --

3 Anyway that -- that one concerns me a little bit less
4 given the proffer that's been made.

5 **MR. FOX:** And just one thing, if I may add on that
6 point and it's not California law. It's federal law.

7 But if I'm recalling correctly -- and I'm thinking on my
8 feet here because we didn't look at this issue -- the -- the
9 blue chip stock (sic) case -- and then I could -- construction
10 of -- of Rule 10(b)(5) which addresses whether there is an
11 implied right of action or not, I believe it deals with
12 questions as to whether to hold a security gives rise to a
13 right of action. And -- and my recollection is the answer is
14 no. It is only purchases and sales.

15 That's only -- that's a "Cf," Your Honor.

16 **THE COURT:** Okay.

17 Unjust enrichment. So in terms of unjust enrichment --
18 unjust enrichment is a theory. It is a contractual theory
19 where someone unjustly confers a benefit through mistake or
20 fraud or coercion.

21 The key Ninth Circuit case, I think, to read on that
22 California claim is *Astiana*, A-s-i-t-a-n-a (sic), vs. *Hain*
23 *Celestial Group*, H-a-i-n Celestial Group, 783 F3d. at 753,
24 Ninth Circuit 2015. It's written by Judge McKeown.

25 Here, it's not clear to me what the plaintiffs provided

1 the defendants with that gave them some kind of monetary
2 benefit.

3 **MR. CARRIEL:** The monetary benefit here is the
4 increase in value to XRB which occurred because plaintiffs and
5 the putative class purchased XRB, and that increase --

6 **THE COURT:** Except that --

7 **MR. CARRIEL:** -- benefited the Nano team because they
8 held 7 million and sold some XRB for themselves.

9 **THE COURT:** Well, you have to be more clear. It's --
10 it's not clear to me what it is you're trying to do there.

11 Look, this is -- I'm going to give you a couple more
12 cites. I think that some of these were already in the
13 briefing.

14 On the fiduciary duty issues, the *Gutierrez* case, which
15 was cited at page 25 of the defendants' opening memo, that has
16 your elements, as does the case *Cleveland* that I gave you.

17 In terms of fraud, look at *Lazar vs. Superior Court*, 12
18 Cal 4th 631, 1996 case. It has that -- the elements and the
19 big issue on all of these fraud claims, including the one with
20 respect to negligent misrepresentation, is you have to have
21 reliance. And that means you have to have something which
22 preceded whatever it was that you were claiming caused the
23 damage, and there has to be a link.

24 You can also take a look at *Charnay*, C-h-a-r-n-a-y, vs.
25 *Cobert*, 145, Cal. App. 4th 179, 2006 case. Those will give

1 you elements.

2 And then the constructive fraud claim that's going to rise
3 and fall with a breach of fiduciary duty and aiding and
4 abetting because it requires a fiduciary or confidential
5 relationship. And with respect to that one, you can take a
6 look at *Sacramento E.D.M., Inc. vs. Hynes Aviation*. That's
7 H-y-n-e-s, 965 F. Supp. 2nd 1141, Eastern District case, 2013.

8 I'm going to grant the motion with leave to amend.

9 **MR. FOX:** Your Honor, may we be heard very briefly on
10 that?

11 **THE COURT:** You may.

12 **MR. FOX:** They're not going -- they're not going to
13 be able to amend their Securities Act claim successfully. The
14 statute of repose begins when a security's bona fide offered
15 to the public.

16 And for background on that, I would -- you know, I would
17 point to the case that we cite on page 7 of our opening brief,
18 *CalPERS vs. ANZ*. It's 137 Supreme Court 2042. They've pled
19 that it was available to the public in October 2017.

20 I know we're talking about a motion to dismiss here, but
21 that is, in fact, true. They also have incorporated by
22 reference a website that demonstrates that fact. So they --
23 they are barred by statute of -- by the statute of repose, and
24 giving them an opportunity to amend is not going to fix that
25 problem.

1 Second point, *Howey*, they're not going to be able to fix
2 that either. What's at issue at *Howey* is the release of the
3 coins. They've themselves replied in paragraph 70, 71, 75
4 through 79 how the coins are released and that they were
5 released for free. That also is true. They cannot plead in
6 good faith anything differently.

7 Third -- and this is, you know -- out there because the
8 first two take care of the third -- statutory seller, they're
9 not going to be able to plead that they either bought the
10 security from the defendants, from Nano, or that Nano made any
11 solicitation in connection with their purchases on the
12 exchange for the benefit of whoever it may have been who was
13 selling the coin on the exchange because Nano didn't sell any
14 coins on the exchange. The exchange was not an underwriter.

15 If they put those -- put that in the allegation, it's
16 going to be false, and it won't be consistent with Rule 11.

17 So there's three reasons why it would be futile for them
18 to amend their complaint on the -- on the 12(a)(1) claim, Your
19 Honor, or on any Securities Act claim for that matter.

20 **THE COURT:** A response?

21 **MR. CARRIEL:** Your Honor, I disagree obviously.

22 So the issue here is what is "bona fide offered." We
23 argue that "bona fide offered" is when XRB was first offered
24 for purchase or sale. They argue that -- or defendants argue
25 that "bona fide offer" is when it was given out for free in

1 the beginning or whenever Nano was first founded.

2 So if we could get some clarification on that point on --
3 on the law here, then we can determine whether or not that
4 aspect of it can -- could be amended and further clarified in
5 support of our claims.

6 **MR. FOX:** Your Honor, with respect, no clarification
7 of the law is needed. The law is very clear about what
8 "bona fide offered" means, and you can look at the cases that
9 are cited in our case -- in our brief -- our opening brief on
10 that point.

11 **MR. CARRIEL:** Your Honor, our opposition brief cites
12 opposing cases, so --

13 **MR. FOX:** No --

14 **THE COURT:** All right. I will tell you what,
15 gentlemen.

16 **MR. CARRIEL:** And then --

17 **THE COURT:** I -- I'm talking.

18 **MR. CARRIEL:** Sorry.

19 **THE COURT:** I will try to address that issue in
20 writing. In the meantime, I'm going to give you 30 days to
21 amend your complaint. If in the interim you receive an order
22 from me that says that those particular claims are dismissed
23 without prejudice, don't include them.

24 Thirty days would be July 25th.

25 **MR. SCOOLIDGE:** Your Honor, if I could just make one

1 more point real quick about the individual defendants and the
2 lack of allegations against them, would the court be willing
3 to hear that?

4 **THE COURT:** Brief.

5 **MR. SCOOLIDGE:** So the complaint really has no
6 allegations at all about what the specific individual
7 defendants did aside from that they made various social media
8 posts at various times. And I think that leave to amend with
9 regard to them probably would also be futile for the same
10 reasons that my colleague mentioned, so I think that we would
11 just ask that they be dismissed with prejudice now, Your
12 Honor.

13 That's all.

14 **THE COURT:** Denied.

15 Okay. How much time do you want to respond to the first
16 amended complaint? Two weeks, three weeks?

17 **MR. SCOOLIDGE:** Thirty days, Your Honor?

18 **THE COURT:** Why would you need 30 days? All your
19 work is done. As far as you're concerned, they can't do
20 anything new.

21 **MR. SCOOLIDGE:** Three weeks is fine, Your Honor.

22 **THE COURT:** All right. Three weeks from filing on 35
23 days' notice. No extensions will be granted. Do not ask for
24 them.

25 The law clerk that I have working on this will be leaving

1 me. I'd like it done before that person leaves.

2 **MR. FOX:** We would as well.

3 **THE COURT:** Okay.

4 The rest is under submission. Have a good summer. Thank
5 you.


6 **MR. SCOOLIDGE:** Thank you, Your Honor.

7 (Proceedings were concluded at 3:53 P.M.)

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11 **CERTIFICATE OF REPORTER**

12
13 I certify that the foregoing is a correct transcript
14 from the record of proceedings in the above-entitled matter.
15 I further certify that I am neither counsel for, related to,
16 nor employed by any of the parties to the action in which this
17 hearing was taken, and further that I am not financially nor
18 otherwise interested in the outcome of the action.

19
20 

21 Raynee H. Mercado, CSR, RMR, CRR, FCRR, CCRR

22 Monday, July 15, 2019
23
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25